

FALL/2008

RE SOURCE™

A GOODWIN PROCTER PUBLICATION FOR THE REAL ESTATE INDUSTRY

REAL ESTATE A Challenging Season

■ Fallout from the
Subprime Collapse

■ Cleaning Up
from the Clean-Up

■ Exit Strategies for
Foreign Investors

■ The Hundredth
Green Building

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REAL ESTATE

A Challenging Season

Fall – an apt metaphor for the current state of the real estate market. As the weather cycle turns a green leaf brittle and fragile, so does the real estate cycle change a blossoming market to something bleak and vulnerable. Unlike the leaf, which changes annually, the real estate down-cycle happens at disparate times with varied root causes.

In the last 18 months, we have witnessed several events – the subprime mortgage meltdown, credit constriction, bank failures, falling home prices, and IRS restrictions – that have combined into a perfect storm, pelting the real estate industry in an unprecedented manner.

Does the storm presage a long, harsh Winter, or a mild cold period on our way to an early Spring?

Only time will tell.

But while the Fall winds are blowing, it is difficult not to notice the vibrant colors of the autumn leaf – the browns, reds, golds, and greens, each underscoring the hallmark of the Fall season: change.

It is obvious to any practitioner that real estate is currently going through significant change, both because of the turmoil affecting real estate and in spite of it. This change is the common thread that links the articles in this issue of *REsource*, whether it is resulting from the subprime mortgage catastrophe, as our first article discusses, or creating opportunities arising out of the problems suffered by financial institutions, as our second article describes. This change is the common experience of real estate practitioners in today's market, whether it is altering the REIT market as the result of an IRS Notice, as our third article illustrates, or transforming to green and sustainable building, as suggested by our fourth article.

It has been said that “changes aren’t permanent, but change is.” That is true for autumn, and it is true with real estate. And it leads to another truth: it has been, and will continue to be, an interesting season.

— Robert M. Haight, Jr.

“The legislative, regulatory, and litigation response to the subprime mortgage collapse is broad, multi-faceted, and dynamic.”



from the Subprime Mortgage Collapse

by Thomas M. Hefferon and Brooks R. Brown

While the subprime mortgage collapse remains front-page news and a central issue, there have been a number of responses to it from various sectors: the United States Congress; state and federal regulators; attorneys general; and private plaintiffs. These responses reveal the legal, regulatory, and litigation climate in which lenders and other subprime market participants must now operate.

The Congressional Response

Just last month, Congress passed, and the President signed into law, the much-publicized Emergency Economic Stabilization Act of 2008, authorizing the Administration's \$700 billion U.S. economic rescue plan. At the forefront of this legislation is the Troubled Asset Relief Program (TARP) to be administered by the Secretary of Treasury

OUT

through the new Office of Financial Security. TARP provides graduated authority for the governmental purchase, either directly or through auction, of up to \$700 billion in financial institution assets, including whole loans or securitized assets from institutions of all sizes. A number of other provisions concerning foreclosure mitigation, banking regulation, tax, health, and other issues were also attached to the legislation.

In July 2008, Congress passed, and the President signed into law, the Housing and Economic Recovery Act of 2008. This broad legislation includes provisions that reform government-sponsored enterprises (GSEs), modernize the Federal Housing Authority (FHA), require new lending disclosures

to borrowers, and encourage the establishment of nationwide licensing and registration for mortgage loan originators.

And, last year, Congress passed the Mortgage Forgiveness Relief Act of 2007. At the core of that law is a provision that excludes from a borrower's taxable income any debt forgiven by a mortgage lender on a primary residence, subject to certain conditions. This exclusion is a change from the general tax precept that treats forgiven debt as taxable income to the borrower. By this change, Congress seeks to facilitate loan workout transactions that may involve a discharge of some portion of a borrower's mortgage debt by eliminating the potential adverse tax consequences of such discharge to the borrower.

Beyond enacting these new laws, Congress has held a number of hearings concerning the subprime mortgage collapse, and a variety of bills have been introduced. These bills – many of which are awaiting further Congressional action – have focused on issues such as the prevention of mortgage fraud and predatory lending, and the promotion of consumer credit education and counseling.

The Regulatory Response

State and federal regulators have also taken action in response to the subprime collapse. For example, earlier this year, Massachusetts' Attorney General enacted new

regulations setting forth certain standards that a home mortgage loan must meet in order *not* to be considered "unfair and deceptive." These regulations impose additional loan disclosure obligations upon lenders and require that lenders have a "reasonable belief" in a borrower's ability to repay his or her loan. Notably, this reasonable belief requirement imposes an affirmative obligation upon lenders to assess a borrower's ability to repay the loan at its fully-indexed rate (as opposed to at an introductory or teaser rate), taking into account amounts for property taxes and insurance. In addition, the Massachusetts regulations make it unlawful for a lender to make a mortgage loan without documentation of the borrower's income, unless the borrower signs a detailed statement attesting to his or her income and disclosing any higher interest rate charged on the loan as the result of the lack of income documentation. And, even where the borrower signs such a statement, the regulations impose a further obligation upon the lender to verify the borrower's income where the stated income amount is not "reasonable."

Government Enforcement Actions

State attorneys general and other government attorneys from across the United States have filed various lawsuits and enforcement actions against lenders and



"With many subprime lenders declaring bankruptcy and others in financial distress, private plaintiffs increasingly have focused their lawsuits on non-lender participants in the subprime and secondary mortgage markets...."

other subprime market participants. As with the legislative and regulatory response, the legal theories for these actions – the vast majority of which are in active litigation and remain to be resolved on the merits – and the relief they seek vary from lawsuit to lawsuit.

For example, government attorneys in Baltimore, Buffalo, and Cleveland have filed actions seeking to force subprime lenders (and other market participants) to shoulder the financial responsibility for remediating the effects of foreclosures upon properties in their cities. These cities allege that lenders and others engaged in irresponsible and unfair lending practices. They claim that these alleged practices and the resulting foreclosures had the foreseeable result of blighting whole neighborhoods, leading to increased criminal activity in homes left vacant after foreclosure, declining property values, a declining real estate tax base, and other lost revenues.

By contrast, other state attorneys general and government attorneys have filed lawsuits seeking to limit or prohibit foreclosures. For example, Massachusetts' Attorney General has filed a lawsuit against Fremont Investment & Loan, alleging that certain loans made by it were "unfair" and in violation of Massachusetts' predatory lending and consumer protection laws. In that lawsuit, the Attorney General sought and obtained a preliminary court order requiring that Fremont submit any loan it intends to foreclose upon to the Attorney General for review as a prerequisite to foreclosure.

Private Plaintiff Lawsuits

Beyond the government enforcement actions, private plaintiffs have filed a host of lawsuits arising out of the subprime mortgage collapse. Lenders are the target of the bulk of these lawsuits, which generally allege violations of federal and state lending and consumer protection laws. Lenders are not, however, the only target. With many subprime lenders declaring bankruptcy and others in financial distress, private plaintiffs increasingly have focused their lawsuits on non-lender participants in the subprime and secondary mortgage markets – e.g., mortgage brokers, title companies, loan purchasers, securities investors, securitizers of debt, and rating agencies. And, while the legal theories for these lawsuits are variant and expanding, a number of the initial cases

have sought – some with success – to impose liability upon these non-lender participants based upon allegations that they conspired with or aided and abetted lenders in the commission of purported improper lending practices.

For example, a class of California borrowers brought suit against Lehman Brothers for aiding and abetting improper lending practices allegedly perpetrated by First Alliance Mortgage – a bankrupt, subprime lender. Over a several-year period, Lehman Brothers provided First Alliance with a multi-million dollar warehouse line of credit for its lending activities and acted as the underwriter of its securitized debt.

After trial, a federal jury awarded damages against Lehman Brothers in excess of \$5 million. In so doing, the jury rejected Lehman Brothers' arguments that it lacked actual knowledge of First Alliance Mortgage's improper conduct and that its provision of general financing to First Alliance Mortgage could not be said to amount to "substantial assistance" toward the commission of the alleged improper conduct. In December 2006, a federal appeals court affirmed the trial court's findings, despite noting that the evidence of Lehman Brothers' alleged actual knowledge of the purported improper conduct was "not overwhelming." Although the Lehman Brothers case is older, it provides valuable lessons for mortgage market participants today.

Conclusion

The legislative, regulatory, and litigation response to the subprime mortgage collapse is broad, multi-faceted, and dynamic. Lenders and other subprime market participants must be cognizant of these responses and other legal developments to navigate successfully in the aftermath of the collapse and to position themselves for the future. ■

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Comedian Steven Wright says: **"When I think of the past, it brings up so many memories."** With those sage words, think back to the early 1990s, and remember the last real estate downturn. And then recall those who prospered handsomely when they had the courage and capital to purchase assets and loans at discounts and then invested to restructure assets and portfolios. For those savvy enough to understand the financial opportunities present today – and those that lay ahead – cleaning up the capital mess can lead to prosperity. So what are some of the strategies to profit when the real estate capital markets are so turbulent?

Turning Red to Gold: Cleaning Up from the Clean-Up



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Loan-to-Own

One strategy is called "Loan-to-Own." Simply stated, an investor buys or makes a loan on a distressed asset and then turns the screws on the borrower through the exercise of remedies when the borrower fails to turn around the troubled project.

Under this approach, a real estate investor purchases or makes a troubled project loan secured with a mortgage or pledge of equity in the current property owner or buyer of the distressed note. On default, after either a foreclosure or deed-in-lieu, the borrower acts like the pink anthropomorphic mountain lion, Snagglepuss, and exits stage right, and the investor gets the asset.

The investor's goal in deploying the Loan-to-Own strategy is to purchase or make the loan at a risk-adjusted discount or interest rate significant enough to overcome the potential transactional and litigation costs, including delay, inherent in the transaction. The investor must underwrite valuation risk on the entry, the potential cost of restructuring the asset, litigation against the borrower and secured and unsecured parties, managing the property, and disposition of the real estate. Bankruptcy issues, lender liability concerns, equitable subordination risks,

by Lewis G. Feldman

fraudulent transfer claims, and characterization of debt as equity are some of the material litigation considerations for an investor. Active participation in the management of a distressed asset can result in reclassifying an investor as a controlling party subject to lender liability. The investor may also confront claims predicated upon a breach of fiduciary duties or the covenant of good faith and fair dealing.

If properly structured and discounted, and the borrower manages to exit without raising the claims discussed, the Loan-to-Own strategy can result in the acquisition of valuable real estate assets at a price that allows for profit.

Acquisition of Structured Securitized Debt

The well-publicized collapse of the market for Commercial Mortgage-Backed Securities, or CMBS, provides potential opportunities for investors. CMBS are tradeable securities collateralized by a pool of commercial mortgage loans from which all of the principal and interest paid on those loans flows to the holders of the securities. On the default of a particular mortgage loan in the pool, the defaulted loan is transferred to

a special servicer. In certain instances, investors may acquire the defaulted loan directly from the special servicer at a steep discount. Another approach is to acquire a controlling class of CMBS securities at a discount in the secondary market and duke it out with investors in other tranches.

Another opportunity relates to Collateralized Debt Obligations, or CDOs. A CDO is a special purpose issuer of fixed-income securities that buys a portfolio of commercial real estate loans, bonds, real estate and corporate asset-backed securities, other CDOs, and derivatives. Unlike CMBS pools, CDOs typically are structured to permit assets to flow in and out of the CDO at the issuer's discretion. Although new CDO issuances today are rarer than a "Ross Perot in 2008" bumper sticker, discounted CDOs are increasingly present in the secondary market due to rating downgrades. Particular challenges in the purchase of a CDO include the lack of transparency, which leads to uncertain portfolio fundamentals and value, litigation risks attendant to CDO issuance and portfolio management, the inheritance of prior legal claims, and restrictions imposed by the original tax structure of the CDO.

Despite the hurdles, there are many opportunities to buy CMBS and CDOs, which if properly discounted, may, in time, become profitable.

Acquisition of Troubled Banks

IndyMac. WaMu. Once revered, these entities are now footnotes in history. Those banks join 19 others so far that have failed in 2008. Along with the failed banks, almost 120-plus banks and thrifts are on credit watch, and over 300 are expected to fail over the next year. With banks teetering on the edge of collapse due to, among other reasons, billions of dollars of distressed real estate debt that the banks originated and intended for securitization, but with no market to buy such debt, banks represent a unique opportunity to investors. A strategy for acquiring distressed real estate is to think like Victor Kiam, the now deceased former owner of Remington Products, who so fell in love with the Remington electric razor his wife gave him as a birthday present in 1979 that he bought the manufacturer. In the case of obtaining an attractive distressed real estate portfolio held by a bank, an investor might consider buying the bank.

Advice on banking laws and the regulatory hurdles is critical. And a strong stomach helps when inheriting a financial institution's balance sheet problems. Depending on the target -- a bank holding company or savings and loan holding company -- different regulatory approvals are needed. Rules are changing quickly to allow equity participants to capitalize banks and thrifts without running afoul of controlling interest rules that can invoke regulatory supervision and operational or investment limitations.

Troubled financial institutions have largely resisted selling, even when stock prices have fallen dramatically. Many believe more bank failures must occur first. Acquirers want to purchase at a deep discount -- a sentiment not often shared by a target institution. Notwithstanding the potential reluctance to sell, many will, thereby creating an opportunity.

Acquisition of Distressed Bank Assets or Debt

For those banks that haven't failed, the legislative and regulatory reaction to the current crisis will be obvious: stricter capital and liquidity requirements. In reaction to these tighter controls, banks will face the need for additional capital, and they will look to offload some of those billions of dollars of real estate debt that they originated and intended for securitization. But, as everyone knows, the distressed capital markets administered a painful body blow to the real estate industry, drastically reducing the market for securitized debt. Without a market to purchase that paper, but with a need for capital, banks will discount sales. A recent example is telling: Merrill Lynch sold \$30.6 billion of collateralized debt obligations to a Lone Star Fund affiliate for \$6.7 billion, which is roughly 22 cents on the dollar.

Acquiring a troubled bank's holdings can be cheaper and bear less risk than buying the bank itself. The FDIC will typically sell the bank's untainted assets and retain the troubled ones. An investor can compete in a portfolio auction and pay whatever the market dictates. Locating assets to purchase before a bank failure may offer a more efficient trade for both the bank and the investor. Faster liquidation and lower transaction costs are just a few of the benefits of directly negotiated purchases.

To identify potentially available product, one must understand which institutions are indeed troubled. Banking regulators do not identify troubled institutions, only the number under credit watch. To find the troubled bank, an investor must properly interpret a bank's financial statements, including capital ratios, loan loss reserves, and regulatory operational directives. It is also informative to find out those banks with construction loans that are having a difficult time funding those loans due to a lack of liquidity.

Broom Time Means Boom Time

As history has shown, with every crisis comes opportunity. In the current crisis, practitioners, government officials, and regulators are attempting to clean up the financial mess that has occurred. But, like in the 1990s, there will be those intrepid investors who employ the strategies discussed in this article and make broom time into boom time. ■



Exit Strategies for Foreign Investors: The IRS Makes A Change

by Edward L. Glazer and John M. Ferguson

The fall in the value of the U.S. dollar, price reductions on real estate, and the attractiveness of hard assets during uncertain times combine to make U.S. real estate very attractive to foreign investors (i.e., non-U.S. investors). For most foreign investors, the investment vehicle of choice has been real estate investment trusts (REITs). Like all investors, foreign investors seek to maximize the after-tax returns from their investments. To do so, they typically try to avoid the payment of substantial taxes on the sale of U.S. real estate assets under the Foreign Investment in Real Property Tax Act (FIRPTA). Until recently, generating a return from investments in REITs and avoiding FIRPTA tax liability could be structured in two ways: selling REIT stock, or selling the REIT assets as part of a liquidation. After a June 2007 Internal Revenue Service (IRS) notice, foreign investors must rethink their exit strategies.

REIT Exit Strategies

Historically, many foreign investors invested in U.S. real estate through domestically-controlled REITs. To realize gain on these investments, the sellers would either (i) sell REIT shares or (ii) the REIT would sell its real estate and make liquidating distributions to its shareholders as the REIT is dissolved. There were many that believed that both exit strategies were exempt from supplemental FIRPTA taxation. In the case of the sale of REIT stock, there is an explicit FIRPTA exception for sales of stock in domestically-controlled REITs. For liquidating distributions, many REITs took the position that the sale of real estate followed by a liquidating distribution was more properly characterized, and taxed, as a sale or exchange of REIT stock (and thereby not subject to FIRPTA) than a distribution relating to the sale of real property (which would be taxable under FIRPTA).

These REITs believed their position was consistent with other circumstances under the Internal Revenue Code in which distributions in complete liquidation were treated as sales or exchanges of shares. Accordingly, and not without interpretive risk, it was common for a REIT to adopt a plan

of liquidation, sell all of its real estate assets to multiple buyers over a two-year period, and then liquidate the REIT by making distributions to the shareholders.

The IRS Steps on the Brakes

Without warning, in June 2007, through IRS Notice 2007-55 (the "Notice"), the IRS announced that, among other things, liquidating distribution gains from domestically-controlled REITs are taxed under FIRPTA. There now would be an approximate 35% federal tax on any such gains, and certain foreign corporate investors may also be subject to an additional branch profits tax, for a total potential tax drag as high as 55%. Suddenly, one of the foreign investors' exit strategies suffered a dramatic cost increase, and REIT sponsors generally have been unwilling to incur the withholding tax risk of taking a position contrary to the Notice. In reaction, many have abandoned the use of domestically-controlled REITs altogether.

For others, the only option left is to explore structures designed for a REIT stock sale exit strategy. While the sale of REIT stock continues to be an economically attractive exit strategy, implementing such sale is not as simple

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as re-styling an asset purchase agreement into a stock purchase agreement. Unlike the pre-Notice days when FIRPTA could be avoided in what was essentially a real estate transaction, the deals are now more akin to corporate M&A transactions.

Selling REIT Shares

A foreign investor must realize that when it attempts to sell shares of a domestically-controlled REIT, the potential buyer of that stock essentially needs to get comfortable with two deals: the underlying real estate, *and* the history, potential liabilities, and tax status of the REIT. In the more recent and very much less frothy real estate market, REIT stock sales have become much more challenging, particularly for smaller properties.

Selling stock in a domestically-controlled REIT requires that a buyer conduct due diligence and seek additional deal protections such as representations, warranties, indemnities, and possible cash holdbacks relating not only to the real estate, but also with respect to the REIT being purchased. Buying a company, and any potential liabilities which may arise from its historical operations, adds incremental risk. For example, REITs do not pay U.S. federal income taxes so long as they earn qualified REIT income, hold qualified REIT assets, meet certain ownership tests, dividend out 90% of their taxable income, and otherwise qualify as a REIT. But, if REIT status fails, then C-corporation entity level tax is imposed (typically 35% before state taxes) on the entity's taxable income. Consequently, in addition to extra deal protections, the transaction may also yield a lower purchase price to offset the incremental assumed risk.

In addition, to employ the sale of REIT stock as an exit strategy, it was and still is necessary to create multiple REITs so that each property or group of properties is owned by its own REIT, such that the stock of the REIT can be sold to a single buyer. In the context of commingled funds, there has been resistance from the U.S. investors needed to make a domestically-controlled REIT possible. Some domestic investors are not amenable to bearing their share of the incremental costs of creating and maintaining a multiple REIT structure or of implementing the sale of the REIT stock exit strategy, which may result in reduced sales proceeds.

The seller's corollary is additional pressure to operate a "clean" REIT to eliminate as many potential liabilities as possible, and additional issues, such as:

- Straining alignment in joint ventures between a private REIT, which is the source of passive capital, and an operating partner with a promoted interest;
- Issues among fund investors and a sponsor; and
- Seller and deal term mismatches.

The desired tax result dictates the sale of stock of a domestically-controlled REIT to a buyer whose stock acquisition does not cause the REIT to be "deREITed." This likely limits the pool of buyers, as one of the REIT requirements is that five or fewer individuals, giving effect to certain attribution and ownership look-through rules, not own more than 50% of a REIT. This "5/50 rule" often eliminates individual, family, family office, closely-held partnerships, and certain other potential buyers. A deREITing acquisition would be a disaster for both the seller and the buyer. The buyer would now own a C-corporation and could not liquidate without setting off a 35% federal tax on the built-in gain imbedded in the corporation. Because the REIT would be deREITed retroactive to the beginning of its current calendar year, the seller loses its desired tax result because the REIT is not a REIT at the time of the sale.

Finding the Right Buyer

Failing to find the right buyer for REIT shares can have a hefty price tag for a foreign investor that wants to liquidate its investment. If a seller plans to but is unable to sell REIT stock and instead must sell the underlying real estate and withhold for FIRPTA, then the foreign investors could bear a total potential tax liability as high as 55%. In a post-

Notice world, given the additional risks associated with sales of REIT stock, foreign investors must carefully analyze the exit strategy in structuring their U.S. real estate investments. Nonetheless, under the right circumstances and with all the right parties, investing through domestically-controlled REITs and disposing of such investments by selling REIT stock remains a very attractive structure for foreign investors. ■

Exit / Sortie

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"Going Green has reached critical mass..."

The Hundredth **Green** Building

by Rachael Simonoff Wexler and Douglas A. Praw

Scientists studying monkeys on an island in Japan dropped sweet potatoes in the sand for the monkeys to eat. The monkeys liked the taste of the sweet potatoes, but were bothered by the sand and dirt encrusting the treats. A young monkey found that she could solve the problem by washing the sweet potatoes in a nearby stream. She began teaching other young monkeys the dipping procedure, but most adult monkeys rejected the technique. The intrepid monkey created a groundswell among her peers, and then something extraordinary occurred. When the hundredth monkey learned to dunk the sweet potatoes in the stream, spontaneously all of the rest of the theretofore reluctant monkeys did so too. This phenomenon is known as the Hundredth Monkey Syndrome and is a parable for what the business community refers to as a tipping point of market acceptance.

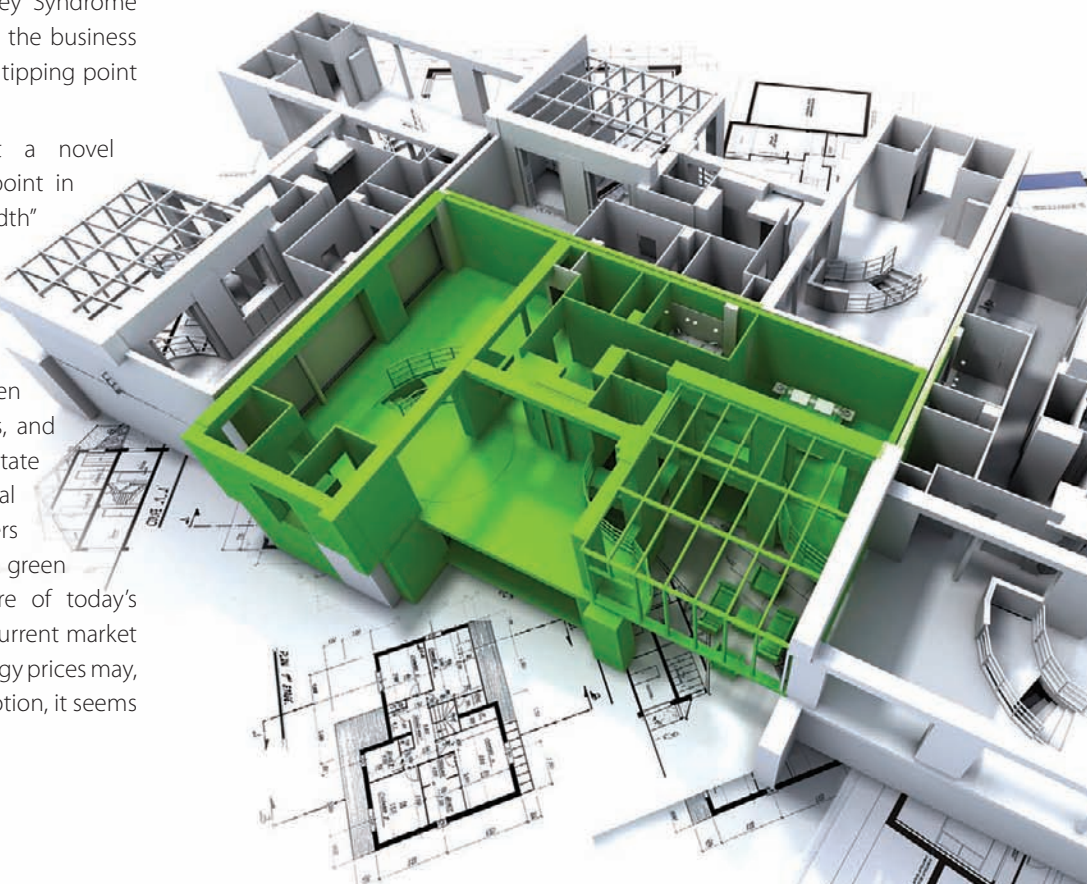
Going green is not a novel concept. But, at some point in the last year, the "hundredth" developer built a green building, and green building achieved its market tipping point. Consequently, going green has reached critical mass, and all participants in real estate – lenders, governmental agencies, and developers – are now witness to green being the central feature of today's building practice. While current market conditions and lower energy prices may, at times, challenge this notion, it seems

unlikely that the current green trends will be reversed. A variety of factors joined together helped green become ubiquitous, including boutique green lending and substantial and lucrative federal and state incentives and tax breaks to developers.

Green Lending

The financing and development options available to developers has grown significantly. Today's credit crunch leaves little money available for traditional projects, however lenders have formed alternative vehicles that provide significant liquidity for attractive green projects. In 2008, JP Morgan announced and began fundraising for its new \$500 million

Green Urban Renaissance Fund that focuses on sustainable urban projects. In January 2008, Morgan Stanley launched a \$200 million fund to invest in solar power installations developed by Recurrent Energy for institutional real estate projects throughout the country. Regional banks that sat on the sidelines of green lending have fallen in line as well and changed their underwriting standards to incentivize green building. Governmental and private sector mandates to support green building mean available capital is earmarked to fund, almost exclusively, green real estate projects. This economic reality, coupled with the existing social support, has made green designs "Tier 1" properties, and all others "Tier 2."



Federal Financial Recovery Plan

The financial recovery legislation, signed into law by President Bush on October 3, 2008, extends the renewable energy tax credits, which were set to expire at the end of the year. The \$17 billion in tax credits will go to businesses and individuals who invest in renewable energy, from building and operating solar and wind power plants to equipping houses with energy-efficient appliances.

Specifically, the financial recovery plan extends and modifies the energy credit, giving an immediate boost to developers and suppliers for green projects by (i) extending, through 2016, the 30% investment tax credit for solar energy property and qualified fuel cell property, and the 10% investment tax credit for microturbine property; (ii) providing for a new 10% investment tax credit for combined heat and power system property and geothermal heat pumps; (iii) increasing to \$1,500 the credit limitation for qualified fuel cell property; (iv) allowing public utility property to be treated as energy property, therefore qualifying for the energy credit; and (v) adding "qualified small wind energy property" as a category eligible for the 30% investment tax credit (up to \$4,000).

State Initiatives and Incentives

New York. In 2000, New York enacted a Green Building Tax Credit for business and personal income taxpayers. The credit can be applied against corporate taxes, personal income taxes, insurance corporation taxes, and banking corporation taxes. Among others, there

are the following credits available: (i) Whole Building Credit; (ii) Base Building Credit; (iii) Tenant Space Credit; (iv) Fuel Cell Credit; (v) Photovoltaic Module Credit; and (vi) Green Refrigerant Credit. These standards applied by the state architect or engineer are designed to increase energy efficiency, improve indoor air quality, and reduce the environmental impacts of large commercial and residential buildings in New York State, among other benefits. The credits are distributed over a five-year period with any unredeemed portion able to be carried forward indefinitely or transferred to a new owner or tenant. A builder, tenant, or owner can use these credits to offset income.

Massachusetts. The New England area boasts a number of incentives as well that assist developers in their green projects. For example, Massachusetts Technology Collaborative ("MTC") is offering financial assistance in the form of loans, ranging from \$500,000 to \$3 million, to support renewable energy companies entering or expanding within the manufacturing stage of commercial development in Massachusetts. Applicants must be companies that currently manufacture, or plan to manufacture, renewable energy technology products in Massachusetts. The investment resulting from MTC financing will result in an expansion of both employment and commercial product.

California. In 2002, California adopted an aggressive Renewable Portfolio Standard. Governor Schwarzenegger mandated that California's investor-owned utilities, energy service providers, and community choice aggregators source 20% of the power they purchase from qualified renewable sources by 2010, with a longer term goal of 33% by the end of the following decade. The main source of renewable energy will be solar energy. The law has spurred

solar adoption and installation in the state. To assist in compliance, the state amended its land secured financing laws to allow public debt to finance solar panels. California's mandate fueled innovation and kick-started the new and growing practice of roof leasing by utility companies. More and more, California utilities are leasing large roof space for the purpose of installing solar cells. The power generated from the cells may be sold back to the owner/occupant at a discount to the grid, thus lowering the cost to the owner and providing a hedge against inflated energy costs.

The New Paradigm

Green finance began on the fringes of social activism and has grown to a significant sector of the financial market. The early growth of green lending allowed for widespread adoption of the federal government's Leadership in Energy and Environmental Design (LEED) Green Building Rating System as the standard of sustainability, now on the cusp of major revision in 2009. After reaching a tipping point sometime in 2008, the sector has been dominated by big banks eyeing cash and cache. As projects have grown in value and bigger institutions have become central players, an exciting new type of real estate diligence has emerged - one that seeks sources of profitability, not just potential future liability. The green building and green lending industries are still nascent, and these industries will continue to change rapidly over the coming years. ■

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